

**SOUTH CAROLINA
EDUCATION LOTTERY COMMISSION**

REPORT ON FINANCIAL STATEMENTS

**FOR THE YEARS ENDED
JUNE 30, 2005 AND 2004**

State of South Carolina



Office of the State Auditor

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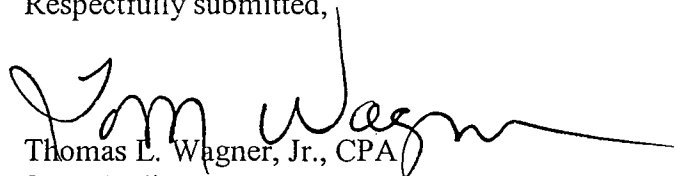
September 28, 2005

The Honorable Mark Sanford, Governor
and
Members of the South Carolina Education Lottery Commission
Columbia, South Carolina

This report on the audit of the financial statements of the South Carolina Education Lottery Commission for the fiscal year ended June 30, 2005, was issued by Elliott Davis, LLC, Certified Public Accountants, under contract with the South Carolina Office of the State Auditor.

If you have any questions regarding this report, please let us know.

Respectfully submitted,


Thomas L. Wagner, Jr., CPA
State Auditor

TLWjr/ksg

SOUTH CAROLINA EDUCATION LOTTERY COMMISSION

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Thomas L. Wagner, Jr., CPA
State Auditor
State of South Carolina
Columbia, South Carolina

We have audited the accompanying statements of net assets of the South Carolina Education Lottery Commission (the Commission), a discretely presented component unit of the State of South Carolina (the State), as of June 30, 2005 and 2004 and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the management of the Commission. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the the Commission as of June 30, 2005 and 2004, and the changes in financial position and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 25, 2005 on our consideration of the Commission's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

The Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements of the Commission. The schedule of business-type activities for the state-wide CAFR is supplementary information required by the South Carolina Office of the Comptroller General and is not a required part of the basic financial statements. It has been subjected to the auditing procedures applied in the audit of the basic financial statements, and in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

Elliott Davis LLC

Elliott Davis, LLC
August 25, 2005

SOUTH CAROLINA EDUCATION LOTTERY COMMISSION MANAGEMENT'S DISCUSSION AND ANALYSIS

Management of the Commission provides this *Management's Discussion and Analysis* of their financial performance for the readers of the Commission's financial statements. This narrative provides an overview of the Commission's financial activity for the fiscal year ended June 30, 2005. This analysis is to be considered in conjunction with the financial statements to provide an objective analysis of the Commission's financial activities based on facts, decisions, and conditions currently facing management.

Understanding the Commission's Financial Statements

The Commission, an instrumentality of the State of South Carolina, is accounted for as an enterprise fund that reports all assets and liabilities using the accrual basis of accounting, much like a private business entity. In accordance with accounting principles generally accepted in the United States of America, this report consists of a series of financial statements, along with explanatory notes to the financial statements. The financial statements immediately follow this discussion and analysis by management, and are designed to highlight the Commission's net assets and changes to those assets resulting from Commission operations.

The most important relationship demonstrated within the Commission's financial statements is the requirement that the Commission transfer all net proceeds to the State Treasurer for the Education Lottery Account. Accordingly, the primary focus of these financial statements is determining net proceeds available for transfer to the Education Lottery Account, rather than the change in net assets of the Commission.

Financial Highlights

Revenues from lottery games increased by \$7.0 million. We returned \$573.6 million to winners of lottery games and \$67.5 million was paid to retailers for commissions and incentives. Other game related expenses were \$18.2 million and operating expenses were \$23.7 million. Transfers to and due to the Education Lottery Account were \$279.7 million as of and for the year ended June 30, 2005.

Assets and Liabilities (in millions)

	<u>2005</u>	<u>2004</u>
Capital Assets	\$ 8.7	\$ 12.2
Other Assets	57.5	72.6
Current Liabilities	57.3	72.7
Long-term Liabilities	1.9	2.9
Net Assets		
Capital Assets Net of Related Debt	6.5	8.8
Restricted Assets	0.5	0.4

Lottery Operations

	<u>2005</u>	<u>2004</u>
Gaming Revenues	\$ 957.0	\$ 950.0
Other Revenues	3.2	3.2
Prizes Expense	573.6	552.3
Retailer Commissions and Incentives	67.5	67.0
Other Direct Game Costs	18.2	20.4
Other Operating Expenses	23.7	23.0

All proceeds of the Commission must be transferred to the State Treasurer for the Education Lottery Account with the following exceptions: 1) the cost of property and equipment net of depreciation and related debt, and 2) the Restricted Fidelity Fund, derived from the licensing fees of new retailers, which may be retained by the Commission up to \$500,000 and used to cover losses the commission may experience due to nonfeasance, misfeasance, or malfeasance of a lottery retailer. Therefore, the net assets of the Commission will never exceed \$500,000 related to the Restricted Fidelity Fund plus the cost of property and equipment, net of depreciation and related debt. As of July 14, 2005 the Commission had transferred \$266 million related to operations and \$14.2 million in unclaimed prize funds to the State Treasurer for the Education Lottery Account for the fiscal year ended June 30, 2005. Total transfers to the Education Lottery Account are \$846 million from inception to June 30, 2005.

Potential Factors Impacting Future Operations

The Commission is considering membership in a new multi-state game now under development by the Multi-State Lottery Association. This is intended to complement Powerball®. Drawings would occur on days other than those of the current Powerball® drawings.

Contacting the Commission's Financial Management

This financial report is designed to provide a general overview of the Commission's financial activity for all those interested in the Commission's operations. Questions concerning any of the information provided in this report, or requests for additional financial information, should be addressed to the Director of Finance, South Carolina Education Lottery, Post Office Box 11949, Columbia, South Carolina 29211-1949.

***SOUTH CAROLINA EDUCATION LOTTERY COMMISSION
STATEMENTS OF NET ASSETS***

	JUNE 30,	
	2005	2004
<i>ASSETS</i>		
CURRENT ASSETS		
Cash and cash equivalents	\$ 17,680,300	\$ 18,265,609
Cash - Restricted fidelity fund	455,330	402,269
Retailer accounts receivable, net of allowance for doubtful accounts of \$167,000 and \$166,000- for 2005 and 2004, respectively	27,410,349	23,389,638
Accounts receivable - Multi-State Lottery	1,509,562	23,277,101
Inventory	2,404,855	2,005,888
Prepaid expenses and other current assets	262,656	93,761
Total current assets	49,723,052	67,434,266
CAPITAL ASSETS, net	8,710,058	12,236,025
DEPOSIT WITH MULTI-STATE LOTTERY	7,753,026	5,127,408
Total assets	66,186,136	84,797,699
<i>LIABILITIES</i>		
CURRENT LIABILITIES		
Due to Education Lottery Account	21,244,269	18,083,373
Prizes payable	23,976,093	24,220,162
Prizes payable - Multi-State Lottery	3,655,771	23,277,101
Accounts payable	5,414,498	3,957,426
Accrued liabilities	877,566	1,004,726
Current portion of accrued compensated absences	58,456	117,385
Current portion of long-term debt	1,104,166	1,232,559
Deferred revenue	998,294	766,454
Total current liabilities	57,329,113	72,659,186
LONG -TERM DEBT	1,113,054	2,217,220
ACCRUED COMPENSATED ABSENCES	795,801	732,778
Total liabilities	59,237,968	75,609,184
<i>NET ASSETS</i>		
Invested in capital assets, net of related debt	6,492,838	8,786,246
Restricted - fidelity funds	455,330	402,269
Total net assets	\$ 6,948,168	\$ 9,188,515

See notes to financial statements which are an integral part of these statements.

SOUTH CAROLINA EDUCATION LOTTERY COMMISSION
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

	For the years ended June 30,	
	2005	2004
REVENUES		
Instant games	\$ 578,838,811	\$ 537,339,766
On-line games	199,175,235	180,480,976
Powerball games	178,937,972	232,186,929
Retailer permit fees	480,600	496,555
Retailer telephone fees	2,645,765	2,596,384
Other	71,079	62,037
Total revenue	<u>960,149,462</u>	<u>953,162,647</u>
DIRECT COSTS		
Commissions and incentives to retailers	<u>67,534,047</u>	<u>66,950,403</u>
Prize expense		
Instant games	396,667,017	359,887,245
On-line games	96,056,371	87,533,205
Powerball games	<u>80,872,481</u>	<u>104,866,608</u>
Total prize expense	<u>573,595,869</u>	<u>552,287,058</u>
Instant and on-line costs	<u>18,175,707</u>	<u>20,385,780</u>
Total direct costs	<u>659,305,623</u>	<u>639,623,241</u>
Gross profit	<u>300,843,839</u>	<u>313,539,406</u>
OPERATING EXPENSES		
Advertising and promotion	7,746,455	6,729,307
Security checks	221,295	176,910
Salaries, wages and benefits	8,717,883	8,707,090
Contracted and professional services	392,031	623,115
Depreciation	3,592,637	3,522,001
Rent expense	815,102	866,110
Office supplies	102,800	167,448
Bad debt expense	110,000	271,092
Other general and administrative	<u>2,006,493</u>	<u>1,967,306</u>
Total operating expenses	<u>23,704,696</u>	<u>23,030,379</u>
Operating Income	<u>277,139,143</u>	<u>290,509,027</u>
NON-OPERATING INCOME (EXPENSE)		
Interest income	590,010	225,481
Interest expense	<u>(231,441)</u>	<u>(602,948)</u>
Total non-operating expense	<u>358,569</u>	<u>(377,467)</u>
Change in net assets before transfers to and due to Education Lottery Account	277,497,712	290,131,560
TRANSFERS TO AND DUE TO EDUCATION LOTTERY ACCOUNT	<u>279,738,059</u>	<u>286,751,598</u>
Change in net assets	<u>(2,240,347)</u>	<u>3,379,962</u>
NET ASSETS,		
BEGINNING OF YEAR	<u>9,188,515</u>	<u>5,808,553</u>
END OF YEAR	<u><u>\$ 6,948,168</u></u>	<u><u>\$ 9,188,515</u></u>

See notes to financial statements which are an integral part of these statements.

SOUTH CAROLINA EDUCATION LOTTERY COMMISSION
STATEMENTS OF CASH FLOWS

	For the years ended June 30,	
	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from retailers	\$ 978,143,880	\$ 937,539,438
Cash payments to prize winners	(593,461,268)	(528,400,705)
Cash payments to suppliers for goods and services	(96,447,799)	(99,569,179)
Cash payments to employees for services	(8,610,662)	(8,644,675)
Net cash provided by operating activities	<u>279,624,151</u>	<u>300,924,879</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Payments to fund deposit with Multi-State Lottery	(2,625,618)	(2,837,099)
Payments to Education Lottery Account	(276,577,163)	(286,486,698)
Net cash used for noncapital financing activities	<u>(279,202,781)</u>	<u>(289,323,797)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from dispositions of capital assets	7,871	8,612
Interest paid	(231,441)	(602,948)
Purchase of capital assets	(87,499)	(593,974)
Net paid for short-term and long-term debt	(1,232,559)	(6,275,052)
Net cash used for financing activities	<u>(1,543,628)</u>	<u>(7,463,362)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest received	590,010	225,481
Net cash provided by investing activities	<u>590,010</u>	<u>225,481</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	(532,248)	4,363,201
CASH AND CASH EQUIVALENTS BEGINNING OF YEAR	<u>18,667,878</u>	<u>14,304,677</u>
END OF YEAR	<u>\$ 18,135,630</u>	<u>\$ 18,667,878</u>
OPERATING ACTIVITIES		
Operating income	\$ 277,139,143	\$ 290,509,027
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	3,592,637	3,522,001
Gain on dispositions of capital assets	(2,792)	(1,012)
Changes in assets and liabilities		
Retailer accounts receivable	(4,004,961)	8,756,920
Accounts receivable - Multi-State Lottery	21,767,539	-
Inventory	(398,967)	276,445
Prepaid expenses and other assets	(168,895)	171,016
Accounts payable and accrued liabilities	1,334,006	(1,815,742)
Prizes payable	(19,865,399)	609,252
Deferred revenue	231,840	(1,103,028)
Net cash provided by operating activities	<u>\$ 279,624,151</u>	<u>\$ 300,924,879</u>

See notes to financial statements which are an integral part of these statements.

SOUTH CAROLINA EDUCATION LOTTERY COMMISSION NOTES TO FINANCIAL STATEMENTS

NOTE 1 - REPORTING ENTITY

The ***South Carolina Education Lottery Commission*** (the Commission), was established as an instrumentality of the state of South Carolina (the State) with enactment of Act 59 of 2001 (the Act). The Commission is responsible for the provision of lotteries on behalf of the State in accordance with the Act. The Act established a board of nine commissioners as an organization legally separate from the State. Three commissioners are appointed by the Governor, three are appointed by the President Pro Tempore of the Senate and three are appointed by the Speaker of the House of Representatives. The Commission exercises powers comparable to those of a governing board of an entrepreneurial organization. The Commission transfers "net proceeds" as defined by the Act to the State. Therefore, the Commission is reported as a discretely presented component unit in the State's Comprehensive Annual Financial Report (CAFR).

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies of the Commission are as follows:

Method of accounting

The Commission is accounted for as an enterprise fund. Enterprise funds are used to account for activities that are financed and operated in a manner similar to private business enterprises where the costs of providing lottery games to the general public on a continuing basis are to be financed through the sale of lottery game tickets. The Act requires that all costs of providing lottery games, including capital costs, be recovered from the sale of lottery game tickets.

The Government Accounting Standards Board (GASB) is the recognized standard setting body for generally accepted accounting principles applicable to governmental proprietary activities in the United States of America. The Commission applies all applicable GASB pronouncements and all applicable Financial Accounting Standards Board (FASB) pronouncements issued on or before November 30, 1989 when not in conflict with GASB pronouncements. In accordance with GASB Statement 20, the Commission has elected not to implement FASB Statements 103 and after.

Basis of accounting

The financial statements are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. Under this method, revenues are recognized when they are earned and expenses are recognized when they are incurred.

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue and accounts receivable recognition

Revenue and accounts receivable for on-line games are recognized when tickets are sold to the public by contracted retailers, except for on-line tickets sold in advance of the draw date for which deferred revenue is recorded.

Revenue and accounts receivable for instant scratch games are recognized upon activation of ticket packs for sale by the retailers. The Commission evaluates its receivables on an ongoing basis for collectability.

(Continued)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

Commissions

Retailers receive a commission of 7% on total sales.

Prizes

In accordance with the Act, as nearly as practical, at least 45% of ticket sales must be returned to the public in the form of prizes. Prize expense for instant ticket games is recorded as an estimate at the time the related revenue is recognized based on the predetermined prize structure for each game; periodically, the prize expense is adjusted to reflect amounts actually won. Prize expense for on-line games is recorded at the time the related revenue is recognized based on the known prizes.

Ticket inventories

Inventories are carried at cost (as determined by the specific identification method) and consist of scratch tickets located in the Commission's warehouses or held by retailers. The cost of tickets is charged to operations upon the recognition of revenue under the procedures described above.

Unclaimed prizes

Prizes must be claimed within 90 days after game-end (end of sales) for instant games and within 180 days after the draw date for on-line games. Unclaimed prize money must be deposited in the Education Lottery Account each year.

Net assets

Net assets represent cumulative revenues less expenses in excess of net proceeds transferred or payable to the Education Lottery Account, as defined under the Act.

Net proceeds

Net proceeds, as defined by the Act, consist of all revenue derived from the sale of lottery game tickets or shares and all other monies derived from the lottery games, less operating expenses and prizes.

Operating expenses

Operating expenses, as defined by the Act, in the determination of net proceeds, consist of all costs of doing business including, but not limited to, prizes, commissions and other compensation paid to lottery retailers, advertising and marketing costs, rental fees, personnel costs, capital costs, depreciation of property and equipment and other operating costs.

Cash and cash equivalents

The Commission considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. This includes cash in banks, petty cash and cash on deposit with the South Carolina State Treasurer.

Retailer accounts receivable

Retailer accounts receivable represents lottery proceeds due from retailers for net ticket sales less commissions and prizes paid by the retailers. Lottery proceeds are collected weekly by the Commission from retailer bank accounts.

Capital Assets

Capital assets, which consist of machinery, equipment, vehicles and leasehold improvements, are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of two to five years. Leasehold improvements are amortized over their expected useful lives or the lease term, whichever is shorter. When assets are retired or otherwise disposed of, the costs and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is reflected in the results from operations in the period of disposal. The Commission capitalizes all property and equipment purchases of \$1,000 or more.

(Continued)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

Restricted fidelity fund

In accordance with the Act, retailers contribute a fee to a fidelity fund upon acceptance as a lottery retailer. The fund is used to cover losses the Commission may incur due to misfeasance, nonfeasance or malfeasance of retailers. At the end of each fiscal year, any amount in the fund in excess of \$500,000 is treated as net proceeds from the Commission and is payable to the Education Lottery Account. At June 30, 2005, no amounts were available for transfer as net proceeds. The fidelity fund is held in a separate account and appears on the balance sheet as restricted fidelity fund cash and in net assets as restricted fidelity funds.

Insurance

The Commission is exposed to various risks of loss related to torts; theft of, damage to, and the destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Commission combines coverage provided by the South Carolina Insurance Reserve Fund with the purchase of commercial insurance to substantially cover these risks.

Compensated absences

Employees earn the right to be compensated during absences for vacation and compensatory time. Unused leave benefits are paid to employees upon separation from service. The cost of vacation and compensatory time is accrued in the period in which it is earned.

Advertising

Costs incurred for producing and communicating advertising are expensed when incurred, which generally is when the advertising first takes place.

Deposit with Multi-State Lottery (MUSL)

The Commission is required to maintain funds in reserve with MUSL. This reserve serves as a contingent source for prize payouts should MUSL games not generate sufficient funds to pay amounts due to prize winners. MUSL is not a financial institution.

Reclassifications

Certain prior year amounts have been reclassified to conform with current year presentation.

NOTE 3 - DEPOSITS

The Commission's cash and cash equivalents are considered to be cash-on-hand and interest bearing demand deposits held by banks and the State Treasurer.

At June 30, 2005 and 2004, the amount of the Commission deposits were as follows:

	2005		2004	
	<u>Carrying amount</u>	<u>Bank balances</u>	<u>Carrying amount</u>	<u>Bank balances</u>
Demand deposits	\$ 551,312	\$ 18,087,424	\$ 18,285,020	\$ 18,816,920
Deposits held by State Treasurer	<u>17,584,318</u>	<u>9,075</u>	<u>382,858</u>	<u>382,858</u>
	<u>\$ 18,135,630</u>	<u>\$ 18,096,499</u>	<u>\$ 18,667,878</u>	<u>\$ 19,199,778</u>

Custodial credit risk - deposits

Custodial credit risk is the risk that in the event of a bank failure, the Commission's deposits may not be returned to it. The Commission does not have a deposit policy for custodial credit risk. As of June 30, 2005 and 2004, none of the Commission's bank balances of \$18,096,499 and \$19,199,778, respectively, were exposed to custodial credit risk.

(Continued)

NOTE 3 - DEPOSITS, Continued**State law**

The Act requires the Commission to transfer to the State Treasurer all net proceeds on a monthly basis. Net proceeds are not available to the Commission for long term investment. State Code Section 11-13-60 requires full collateralization of all deposits held by the State Treasurer.

NOTE 4 - CAPITAL ASSETS

The following is a summary of changes in capital assets and accumulated depreciation during fiscal year 2005:

	<u>Balance</u> <u>June 30, 2004</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>June 30, 2005</u>
Cost				
Machinery and equipment	\$ 19,836,623	\$ 87,499	\$ 35,724	\$ 19,888,398
Vehicles	68,826	-	-	68,826
Leasehold improvements	<u>641,349</u>	<u>-</u>	<u>-</u>	<u>641,349</u>
	<u>20,546,798</u>	<u>87,499</u>	<u>35,724</u>	<u>20,598,573</u>
Accumulated depreciation				
Machinery and equipment	(7,991,631)	(3,447,995)	14,895	(11,424,731)
Vehicles	(48,954)	(16,372)	-	(65,326)
Leasehold Improvements	<u>(270,188)</u>	<u>(128,270)</u>	<u>-</u>	<u>(398,458)</u>
	<u>(8,310,773)</u>	<u>(3,592,637)</u>	<u>14,895</u>	<u>(11,888,515)</u>
Total property and equipment, net	<u>\$ 12,236,025</u>	<u>\$ (3,505,138)</u>	<u>\$ (20,829)</u>	<u>\$ 8,710,058</u>

The following is a summary of changes in capital assets and accumulated depreciation during fiscal year 2004:

	<u>Balance</u> <u>June 30, 2003</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>June 30, 2004</u>
Cost				
Machinery and equipment	\$ 19,271,419	\$ 576,143	\$ (10,939)	\$ 19,836,623
Vehicles	68,826	-	-	68,826
Leasehold improvements	<u>623,518</u>	<u>17,831</u>	<u>-</u>	<u>641,349</u>
	<u>19,963,763</u>	<u>593,974</u>	<u>(10,939)</u>	<u>20,546,798</u>
Accumulated depreciation				
Machinery and equipment	(4,623,983)	(3,370,988)	3,340	(7,991,631)
Vehicles	(26,012)	(22,942)	-	(48,954)
Leasehold Improvements	<u>(142,117)</u>	<u>(128,071)</u>	<u>-</u>	<u>(270,188)</u>
	<u>(4,792,112)</u>	<u>(3,522,001)</u>	<u>3,340</u>	<u>(8,310,773)</u>
Total property and equipment, net	<u>\$ 15,171,651</u>	<u>\$ (2,928,027)</u>	<u>\$ (7,599)</u>	<u>\$ 12,236,025</u>

NOTE 5 - ACCRUED EXPENSES

Accrued liabilities at June 30, 2005 consist of the following:

Accrued payroll and related expenses	\$ 821,455
Other	<u>56,111</u>
	<u>\$ 877,566</u>

Accrued liabilities at June 30, 2004 consist of the following:

Accrued payroll and related expenses	\$ 942,926
Other	<u>61,800</u>
	<u>\$ 1,004,726</u>

NOTE 6 - LONG-TERM DEBT AND COMMITMENTS

In October 2001, the Commission entered into a six year contract with a vendor, to provide amongst other things, services and equipment to operate their on-line lottery. The contract required an initial payment of \$5,287,938, which has been paid. The contract also calls for monthly administrative fees of \$450,000 for the life of the contract. Under the original contract, additional payments, which have been imputed for the purchase of equipment of \$140,000 and \$122,000 per month, will be made for months three through twenty-six and twenty-seven through sixty-two of the contract, respectively. These additional payments have been imputed to include principal and interest at 8%. A lump sum payment of \$5,270,000 was due and paid in March 2004. Title to and risk of loss for this equipment occurred upon installation and acceptance in March 2002.

In January 2005, the contract for the vendor to provide administrative services was extended for an additional ten and a half (10½) months through November 15, 2008. The extension will require ten monthly payments of \$450,000 with a final payment of \$225,000.

At June 30, 2005, the future maturities of the imputed principal and interest payments on the equipment are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Payment</u>
2006	\$ 1,104,166	\$ 129,136	\$ 1,233,302
2007	<u>1,113,054</u>	<u>25,088</u>	<u>1,138,142</u>
	<u>\$ 2,217,220</u>	<u>\$ 154,224</u>	<u>\$ 2,371,444</u>

The following is a summary of changes in long-term debt during fiscal year 2005:

	<u>Balance</u> <u>June 30, 2004</u>	<u>Proceeds</u>	<u>Payments</u>	<u>Balance</u> <u>June 30, 2005</u>
Long-term debt	<u>\$ 3,449,779</u>	<u>\$ -</u>	<u>\$ 1,232,559</u>	<u>\$ 2,217,220</u>

The following is a summary of changes in long-term debt during fiscal year 2004:

	<u>Balance</u> <u>June 30, 2003</u>	<u>Proceeds</u>	<u>Payments</u>	<u>Balance</u> <u>June 30, 2004</u>
Long-term debt	<u>\$ 9,724,831</u>	<u>\$ -</u>	<u>\$ 6,275,052</u>	<u>\$ 3,449,779</u>

NOTE 7 - ACCRUED COMPENSATED ABSENCES

The following is a summary of changes in accrued compensated absences during fiscal year 2005:

	<u>Balance</u> <u>June 30, 2004</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance</u> <u>June 30, 2005</u>
Accrued compensated absences	<u>\$ 850,163</u>	<u>\$ 499,951</u>	<u>\$ 495,857</u>	<u>\$ 854,257</u>

The following is a summary of changes in accrued compensated absences during fiscal year 2004:

	<u>Balance</u> <u>June 30, 2003</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance</u> <u>June 30, 2004</u>
Accrued compensated absences	<u>\$ 783,363</u>	<u>\$ 474,192</u>	<u>\$ 407,392</u>	<u>\$ 850,163</u>

NOTE 8 - OPERATING LEASES

The Commission has entered into operating leases for the rental of office space for its headquarters and district offices. Certain operating leases contain provisions for scheduled rental increases and are renewable at the option of the Commission.

Future minimum rental payments, to entities outside the State reporting entity, on noncancellable leases with original terms of one year or more are scheduled as follows for the year ending June 30:

	<u>Operating</u> <u>leases</u>
2006	\$ 347,414
2007	70,896
2008	4,042

Rental expenses under all operating leases including those on month-to-month terms totaled approximately \$815,000 and \$866,000 for the year ended June 30, 2005 and 2004, respectively. This includes \$65,739 and \$84,669 of vehicle rental expense to the State Fleet management.

NOTE 9 - DUE TO EDUCATION LOTTERY ACCOUNT

In accordance with the Act, all net proceeds of the Commission are to be transferred to the Education Lottery Account within the State Treasury. In accordance with the Act, net proceeds consist of all revenue derived from the sale of lottery game tickets or shares and all other monies derived from the lottery games less operating expenses and prizes. The following payables resulted from transfers due to the Education Lottery Account at June 30:

	<u>2005</u>	<u>2004</u>
Amount payable to the Education Lottery Account, beginning of year	\$ 18,083,373	\$ 17,818,473
Change in net assets subject to transfer	<u>277,497,712</u>	<u>290,131,560</u>
	<u>295,581,085</u>	<u>307,950,033</u>
Change in capital assets, net of related debt		
Property and equipment, net	3,525,967	2,935,626
Long-term debt	<u>(1,232,559)</u>	<u>(6,275,052)</u>
	<u>2,293,408</u>	<u>(3,339,426)</u>
Amount collected for fidelity fund	<u>(53,061)</u>	<u>(40,536)</u>
Amount paid during the year	<u>(276,577,163)</u>	<u>(286,486,698)</u>
Amount payable to the Education Lottery Account, end of year	<u>\$ 21,244,269</u>	<u>\$ 18,083,373</u>

Transfers related to the above payable were made to the Education Lottery Account in July 2005.

NOTE 10 - EMPLOYEE RETIREMENT SYSTEMS

The Commission contributes to the South Carolina Retirement System (SCRS) cost sharing multiple-employer defined benefit plan administered by the Retirement Division of the State Budget and Control Board.

As established by Title 9-1-480 Code Laws of South Carolina, 1976 (as amended), all eligible persons, except those specifically excluded, shall become members of the retirement system as a condition of their employment. The responsibility of the administration of the system is assigned by law to the State Budget & Control Board.

SCRS offers retirement and disability benefits, cost of living adjustments on an ad-hoc basis, life insurance benefits and survivor benefits. The Plan's provisions are established under Title 9 of the SC Code of Laws.

The following is a recap of the mandated contribution rates for the current fiscal year.

	<u>SCRS</u>
Employee contributions	6% of salary
Employer contributions	
Retirement	7.55% of salary
Insurance surcharge	3.25% of salary
Group life insurance	.15% of salary

For the years ending June 30, 2005, 2004 and 2003 the Commission contributions to SCRS were \$710,153, \$699,039 and \$605,768, respectively.

All employer contributions were equal to the required contribution rates for the year. Contributions as a percentage of statewide contributions were not available for June 30, 2005.

(Continued)

NOTE 10 - EMPLOYEE RETIREMENT SYSTEMS, Continued

A comprehensive annual financial report containing financial statements and required supplementary information for the South Carolina Retirement System is issued and publicly available by writing the South Carolina Retirement System, Post Office Box 11960, Columbia, South Carolina 29211-1960.

NOTE 11 - CONTINGENCIES

The Commission is subject to litigation in the ordinary course of its business. In the opinion of management and legal counsel, the outcome of such litigation will not have a material impact on the financial position or cash flows of the Commission for the year ending June 30, 2005.

NOTE 12 - TRANSACTIONS WITH STATE ENTITIES AND RELATED PARTIES

For the year ended June 30, 2005, the Commission had certain transactions with the State and various other state agencies as follows:

<u>Related Party</u>	<u>Amount</u>	<u>Nature of Transaction</u>
South Carolina Department of Revenue	\$ 6,598,192	Transfers of state tax withholding, use taxes and debt setoffs
SLED	316,341	Security services and fees paid for background checks on employees and retailers
South Carolina State Treasurer	276,577,163	Transfers of net proceeds and unclaimed prizes
South Carolina State Treasurer	8,316,391	Transfer of payroll funds for processing
Comptroller General	39,258	Fees for payroll processing and unemployment insurance
South Carolina Budget & Control Board	357,319	Insurance, telephone, printing, miscellaneous services
Prison Industries - Department of Corrections	6,679	Recycling services and office furniture
South Carolina Department of Social Services	31,525	Debt setoffs withheld from prize winnings
South Carolina Department of Public Safety	241,266	Security services
	<u>\$ 292,484,134</u>	

NOTE 12 -TRANSACTIONS WITH STATE ENTITIES AND RELATED PARTIES, Continued

For the year ended June 30, 2004, the Commission had certain transactions with the State and various other state agencies as follows:

<u>Related Party</u>	<u>Amount</u>	<u>Nature of Transaction</u>
South Carolina Department of Revenue	\$ 7,670,388	Transfers of state tax withholding, use taxes and debt setoffs
SLED	249,208	Security services and fees paid for background checks on employees and retailers
South Carolina State Treasurer	286,487,698	Transfers of net proceeds and unclaimed prizes
South Carolina State Treasurer	7,485,998	Transfer of payroll funds for processing
Comptroller General	37,300	Fees for payroll processing and unemployment insurance
South Carolina Budget & Control Board	168,458	Insurance, telephone, printing, miscellaneous services
Prison Industries - Department of Corrections	17,654	Recycling services and office furniture
South Carolina Legislative Audit Council	104,777	Audit
South Carolina Department of Social Services	28,589	Debt setoffs withheld from prize winnings
South Carolina Department of Public Safety	<u>240,110</u>	Security services
	<u>\$ 302,490,180</u>	

***SOUTH CAROLINA EDUCATION LOTTERY COMMISSION
SUPPLEMENTARY SCHEDULE OF BUSINESS-TYPE
ACTIVITIES FOR THE STATEWIDE CAFR***

	For the years ended June 30,	
	<u>2005</u>	<u>2004</u>
Charges for services	\$ 960,149,462	\$ 953,162,647
Operating grants and contributions	590,010	225,481
Less expenses	<u>683,241,760</u>	<u>663,256,568</u>
Net program revenue	277,497,712	290,131,560
Transfers out to state agencies/funds	<u>(279,738,059)</u>	<u>(286,751,598)</u>
Change in net assets	(2,240,347)	3,379,962
NET ASSETS - BEGINNING	<u>9,188,515</u>	<u>5,808,553</u>
NET ASSETS - ENDING	<u><u>\$ 6,948,168</u></u>	<u><u>\$ 9,188,515</u></u>



**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL
OVER FINANCIAL REPORTING AND ON COMPLIANCE AND
OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

Thomas L. Wagner, Jr., CPA
State Auditor
State of South Carolina
Columbia, South Carolina

We have audited the financial statements of the *South Carolina Education Lottery Commission* (the Commission), a discretely presented component unit of the State of South Carolina (the State), as of and for the years ended June 30, 2005 and 2004, and have issued our report therein dated August 25, 2005. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audits, we considered the Commission's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Commission's financial statements are free of material misstatement, we performed tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the audit committee, management of the Commission and the Office of the State Auditor of South Carolina and is not intended to be and should not be used by anyone other than these specified parties.

Elliott Davis LLC

August 25, 2005

***SOUTH CAROLINA EDUCATION LOTTERY COMMISSION
SCHEDULE OF FINDINGS
For the year ended June 30, 2005***

SCHEDULE OF AUDITOR'S RESULTS

We have issued an unqualified opinion, dated August 25, 2005 on the financial statements of the Commission as of and for the year ended June 30, 2005.

Our audit disclosed no instances of noncompliance which are material to the Commission's financial statements.

Our audit disclosed no reportable conditions or material weaknesses relating to the audit of the financial statements.

FINDINGS RELATING TO THE FINANCIAL STATEMENTS

Our audit disclosed no findings which are required to be reported in accordance with *Government Auditing Standards*.